No. 11396

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

UNITED STATES OF AMERICA,

Appellant,

vs.

JAMES H. ADAMSON and MARION C. ADAMSON,

Appellees.

Upon Appeal from the District Court of the United States for the Southern District of California, Central Division

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BRIEF FOR JAMES H. ADAMSON AND MARION C. ADAMSON, APPELLEES.

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I.

Preliminary Statement.

As indicated in the appellant's brief, the facts in this case are not in dispute and substantially all the facts, as well as the issue involved, were stipulated. Because of the complete statement of the facts set forth in appellant's brief, appellees will merely refer to the record wherever indicated in their argument.

II.

Question Presented.

Appellees concur in appellant's statement of the question presented by this appeal, which is whether the sum of $32,500.00 received in 1940 by James H. Adamson under the agreement of October 20, 1939, constituted ordinary income or whether it constituted gain upon the sale of a capital asset within the meaning of the Internal Revenue Code.

III.

Argument.

It is appellees' position that James H. Adamson, one of the taxpayers herein, by the said agreement dated October 20th, 1939 [R. 48-60], sold to his brother, Percy Adamson, either of the following:

1. His interest in the partnership of Adamson Bros. Company, or
2. An undivided one-half interest in the United States Rubber Company contracts, the invention, the pattent, and in the trademark "Lastex."

Regardless of which of the foregoing the said transaction is deemed to be, the payments received under said contract would nevertheless constitute a long-term capital gain within the meaning of the Internal Revenue Code.

The facts in the instant case are clear and simple when stripped of many irrelevant circumstances. James H. Adamson and his brother entered into a partnership at will in 1925 to engage in the business of developing and dealing in yarns and textiles, including the developing of ideas in the field of special yarns. [R. 14.] In the course of that business, one of the partners, Percy Adamson, developed an idea for the manufacture of a yarn known as "Lastex," which he patented. [R. 15.] This invention, as well as the patent in which it was embodied, together with the trademark "Lastex," was owned by and was the property of the copartnership. [R. 15.]

In April, 1931, and January, 1932, Percy Adamson entered into two contracts with the United States Rubber Company in connection with the use and license of the patent and trademark [R. 16], which contracts, as the

court later determined, were likewise the property and assets of the copartnership. [R. 37.] Percy Adamson thereafter repudiated the partnership which necessitated litigation to establish James H. Adamson's interest in the assets which Percy claimed to be his own. [R. 17.] The partnership terminated December, 1932. [R. 14.] From that time on, James H. Adamson was no longer engaged in any business pertaining to developing and dealing in yarns and textiles or in the developing and selling of inventions, patents or trademarks. [R. 97-98.] It is obvious therefore that he held his interest in the assets which belonged to the partnership as an investment and not for use or sale to customers in the course of operation of any business.

By the agreement of October 20th, 1939, James H. Adamson sold all of his right, title and interest in all of the said assets or in the partnership to his brother, Percy Adamson. [R. 48-60.] It is the nature of the proceeds from this sale which is the subject of this controversy. Is it ordinary income or is it a long-term capital gain?

It is apparent from the facts that the income in question was the proceeds from the sale of either the partnership interest or of the undivided one-half interest in the specific assets. Appellees submit that it is immaterial which of the two James H. Adamson sold because the sale of either would constitute the sale of a capital asset under the circumstances of this case.

The Tax Court of the United States, in considering the identical question in a proceeding involving the year 1939, has ruled that by the contract of October 20, 1939, James H. Adamson "disposed of *all* his interest in the then remaining assets of the partnership, including the Rubber

Company contracts and any interest he may then have had in the patent and trademark, which although the partnership had been terminated had not theretofore been divided and distributed." (*James H. Adamson v. Commissioner of Internal Revenue,* Docket No. 3154, decided December 11th, 1946, ... T. C. ....) The Tax Court concluded that the payments received by James H. Adamson under the said contract of October 20th, 1939, "constituted proceeds from the sale of capital assets and that it is subject to tax at long term capital gain rates under Sections 117(a) and (b) of the Code."

Other courts have held that the sale of assets of the type sold by the agreement of October 20th, 1939, constituted the sale of capital assets. In *Anna Taylor,* 3 B. T. A. 1201, and *Alice G. K. Klaberg,* 2 T. C. 1024, the sale of a royalty agreement was held to be to sale of a capital asset. In *Commissioner v. Hopkinson* (C. C. A. 2), 127 F. (2d) 406, and in *Commissioner v. Celanese Corporation of America,* 140 F. (2d) 339, the sale of a patent was held to be the sale of a capital asset. In *Seattle Brewing Company,* 6 T. C. ......, and *Rainier Brewing Company,* 7 T. C. ......, the sale or purchase of a trade name was held to be the sale of a capital asset. In *Stilgenbauer v. U. S.* (C. C. A. 9), 115 F. (2d) 283, the sale of a copartnership interest in personal property was held to be the sale of a capital asset.

Since the invention, patent, trademark and the United States Rubber Company contracts were all acquired by the partnership during the years 1931 and 1932, and disposed of on October 20, 1939, they were held by the taxpayer for more than 24 months. See G. C. M. 20251.

From the language of the agreement of October 20, 1939, it might also be construed that James H. Adamson was disposing of his interest in the partnership of Adamson Bros. Company, as distinguished from his interest in the specific assets. Although it is true that the partnership was terminated on or about the month of December, 1932, it might nevertheless be deemed to have continued in existence for the purpose of winding up and completing the executory contracts with the United States Rubber Company. Under the circumstances, it might be deemed that what James H. Adamson sold under the contract of October 20th, 1939, was an interest in the partnership.

The sale of the partnership interest has been held to be the sale of capital assets under the circumstances of this case.

> *Thornly v. Commissioner* (C. C. A. 3), 147 F. (2d) 416;
>
> *Commissioner v. Shapiro* (C. C. A. 6), 125 F. (2d) 532;
>
> *Dudley T. Humphrey,* 32 B. T. A. 280;
>
> *Estate of George R. Nutter,* 46 B. T. A. 35;
>
> *Kessler v. U. S.,* 124 F. (2d) 152;
>
> *Stilgenbauer v. U. S., supra,*
>
> *Tehman,* 7 T. C. ......, No. 128.

Appellees submit that the alleged inconsistency in the agreement of October 20th, 1939, as to whether the said agreement disposes of an interest in a partnership or an interest in specific assets is immaterial, as the purpose of the clause was to give the buyer further assurance of his title and for the purpose of securing to the purchaser

the absolute and exclusive ownership, possession and title to the property sold. See

Seattle Brewing Company, 6 T. C. ......, and

Commissioner v. Celanese Corporation of America, supra.

Prior to the execution of the agreement, the taxpayer owned an interest in the partnership, even though it was inactive. After the execution of the instrument, he owned no interest in the partnership. Before the execution of the said contract, Percy Adamson owned a copartnership interest in the partnership. After the execution of the said contract, he was the sole and absolute owner thereof. This constitutes a sale of a partnership interest.

Seattle Brewing Company, supra;

Commissioner v. Hopkinson, supra;

Thornly v. Commissioner, supra.

Assuming that the property received by Percy Adamson consisted of an interest in specific assets this would not take the transaction out of Section 117(b) of the Internal Revenue Code. This section applies whether the transaction be a sale or an exchange. If the taxpayer gives up his partnership interest and his purchaser pays him the consideration therefor, then the proceeds received by the taxpayer are from an exchange, whether or not his purchaser receives the same assets which the taxpayer gives up.

Kessler v. U. S., supra;

Thornly v. Commissioner, supra.

The sale or exchange of the partnership interest which was acquired in November, 1925, and disposed of on October 20, 1939, resulted in a long-term capital gain.

IV.

Reply to Appellant's Argument.

While it is true that in a suit against the United States to recover amounts paid as federal income tax the burden is upon the taxpayer to prove that he actually has overpaid his taxes, we submit the taxpayer has sustained the burden in the present case.

It is an elementary principle of law that requires no citation of authority that the findings of the trial court are to receive such consideration as will uphold rather than defeat its judgment thereon and wherever from the facts found by it, other facts may be inferred which will support the judgment, such inferences will be deemed to have been made and upon an appeal from the judgment, the Appellate Court will not draw from those facts any inferences of fact contrary to that which may have been drawn by the trial court for the purpose of rendering judgment.

The trial court's findings of facts are not to be disturbed upon review if there is any evidence to support such findings, and this is so even where there is a conflict in the evidence.

> *Wells Fargo Bank etc. v. McLaughlin* (C. C. A. 9), 78 F. (2d) 934, certiorari denied 296 U. S. 638;
>
> *United States v. Union Trust Co.* (C. C. A. 7), 90 F. (2d) 702.

The appellant urges that appellees have not brought themselves squarely within the provisions for taxation of capital gains because there is no indication either in agreements or in the record as to the nature or extent of other

assets covered by the sale or whether such other assets, if any, were capital assets within the meaning of Section 117(a) or whether they were held for the length of time within the meaning of Section 117(b). In this regard we respectfully submit that the position of the appellant is without merit.

There was not even a shred of evidence to indicate that there were any assets the subject of the contract in question other than the invention, the patent, the trademark and the United States Rubber Company contracts. It is quite obvious from a consideration of the agreement of October 20th, 1939, that the parties used general language to give the purchaser further assurance that he was receiving clear title to the particular assets conveyed rather than any intimation that there were any other assets. The trial court obviously so construed the agreement.

The action brought by James H. Adamson in the Supreme Court of New York against Percy Adamson was "for a disposition of the partnership and for an accounting of the affairs and the property of said partnership. [R. 17.] It is apparent from the record that the Supreme Court of the State of New York by its judgment intended to and did settle the accounts of the partnership and divided and distributed all of the assets of the partnership. [R. 42-46.] An examination of the findings of fact, the conclusions of law and the judgment made and entered in the New York action shows that there were no other assets or property of any kind and nature belonging to the partnership which could be the subject of sale contemplated by the agreement of October 20th, 1939, except the specific items enumerated in said agreement, to wit: The invention, the patent, the trademark and the United States Rubber Company contracts. As heretofore indi-

cated, the Tax Court likewise ruled as did the trial court that by the contract James H. Adamson "disposed of *all* his interest in the then remaining assets of the partnership."

Adamson v. Commissioner, supra.

The government admits in its brief at page 16:

> "The only vestige of his former partnership interest was an undivided one-half interest as tenant in common in the 'Lastex' patent and trademark and an undivided one-half interest as tenant in common in the royalty and service agreements with the United States Rubber Company."

It was stipulated that the assets consisted "primarily" of the specific enumerated assets. [R. 19.] Certainly the trial court could and must have inferred that there were no other assets. Nor was it the duty of the taxpayer to negative the existence of all facts adverse to his claim.

Helvering v. Taylor, 293 U. S. 507.

If there were any other assets, they as well as the assets specifically enumerated would be capital assets within the meaning of Section 117(a)(1) of the Internal Revenue Code. Obviously the assets would not be excluded from the category of capital assets because at the time of the sale or exchange the taxpayer was not engaged in any business in which any of said assets were used and consequently they were not of the kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year; nor were they held by him for sale to customers in the course of his trade or business. Clearly, they were not used in James H.

Adamson's trade or business in the year 1940. As stated by the Tax Court in *Adamson v. Commissioner, supra:*

> "From at least the time petitioner (James H. Adamson) commenced his suit in 1934 for an accounting, he merely held his interest in partnership assets awaiting the final division and distribution."

The fact that the taxpayer has shown no cost as to these specific assets is entirely immaterial. He treated the entire payment as a gain. As all the assets sold by James H. Adamson were capital assets, it would be useless to allocate the consideration received therefor so as to show which part of the consideration was received for which asset. The resultant gain and the tax thereon would always be the same.

The cases cited by the government on page 17 of their brief, to wit, *City Bank Farmers Trust Company v. U. S.,* 47 Fed. Supp. 98, and *City Bank Farmers Trust Company v. U. S.,* 47 Fed. Supp. 105, were cases decided by the Court of Claims and the Tax Court and Circuit Court of Appeal for the Third Circuit both refused to follow these cases.

For the first time in its brief, at page 15, appellant raises the point that the taxpayer has failed to prove that he actually overpaid his tax for 1940 by reason of an alleged failure to include in his reported income the sum of $50,000.00 to be paid to his attorneys pursuant to the agreement of October 20th, 1939. In the first place, there is no evidence whatsoever whether or not the said sum of $50,000.00 was ever paid to the taxpayer's attorneys during the year in question, nor was there any evidence as to whether or not the taxpayer did or did not include any

sum so paid in his reported income. Under the circumstances, the trial court was justified in concluding

1. That such payment was not made, or

2. That if made, was properly reported by the defendant.

In this connection, it must be called to the Court's attention that by stipulation of facts, the point in controversy was narrowed down to the nature of the $32,500.00 received by the plaintiff under the agreement dated October 20th, 1939. [R. 12.] Under paragraph IV of the Stipulation of Facts it was provided that "the difference between the computations of the plaintiffs and the computations of the government result from the inclusion in said return of the sum of $32,500.00 received . . . under an agreement dated October 20th, 1939. . . ." The government itself is thoroughly in accord with this construction of the stipulation, as appears from the following statement found on page 12 of its brief:

> "In this case there is no controversy over the amount of income or profit received in the year 1940 under the contract of October 20th, 1939. . . . The principal question is whether the amount received is taxable as ordinary income or as gain from the sale of a capital asset."

Under the Stipulation of Facts there was no question as to whether or not the income was correctly reported and the trial court was not called upon to determine that issue. Such an issue, therefore, cannot now be raised by the government. The burden was not upon the taxpayer to negative the possibility of income beyond the amount already reported by him.

Helvering v. Taylor, 293 U. S. 507.

Although the matter of moneys paid to the attorneys is not in issue in this case, it is respectfully submitted that if such payments are includable in taxpayers' gross income, they are likewise includable under his deductions and as an expense paid during the taxable year for the conservation of property held for the production of income. [R. 51.] Section 23 (A) (2) of the Internal Revenue Code, which was added by the Revenue Act of 1942 and made effective retroactively for taxable years beginning after December 31st, 1938, by Section 121 (D).

The government argues on page 17 of its brief that to the extent that any part of the consideration received by the taxpayer under contract of October 20th, 1939, was for the sale of the judgment obtained against Percy Adamson, the same could not constitute the payment for a capital asset. Percy Adamson was the purchaser under the agreement of October 20, 1939. This argument would deserve no recognition were it not for the fact that it eloquently demonstrates that the provision contained in said contract for the transfer to the purchaser of specific assets was placed therein solely to divest the taxpayer of, and to vest the purchaser with, the absolute ownership of the taxpayer's partnership interest. In this connection appellees wish to point out that in the same contract not only did the taxpayer transfer the judgment to the purchaser, but he also agreed to execute a satisfaction of said judgment. [R. 57.]

The government contends that no part of the payments made or to be made to the taxpayer under the agreement of October 20, 1939, which represented payment for release by the taxpayer of his right to receive future income under the agreements with the United States Rubber

Company, can be treated as a payment for a capital asset. It is respectfully submitted that no part of such consideration was ever received by the taxpayer for the release of such royalty income.

The Tax Court stated in its recent decision in the matter of *Adamson v. Commissioner, supra:*

> "Nor do we think it may be said that any part of the $215,000.00 represents royalties and commissions that were to accrue in the future, the Rubber Company was bound at all events to pay petitioner the stipulated sum in consideration of the transfer of all petitioner's interest in the partnership assets, regardless of whether future sales of 'lastex' products were made by or for the Rubber Company, or whether its contracts with Percy continued to exist."

If the taxpayer did not sell his interest in the partnership, then he must have sold his interest in the royalty agreement. He certainly owned such interest until the contract of October 20, 1939, and, after he executed the said contract, he no longer had any such interest. Had the taxpayer *retained* his interest in the royalty agreement and merely sold the purchaser his right to the royalties, for a limited time, then there might have been some merit to the government's contention. But a distinction is to be made between the sale of corpus and the sale of the income produced by such corpus.

> *J. V. Leydig,* 15 B. T. A. 124;
>
> *Fox,* 37 B. T. A. 271.

The government cites the case of *Hort v. Commissioner,* 313 U. S. 28, which we respectfully submit is not in point: This case decides that where a landlord cancels his lease

with the tenant as consideration for the payment of a lump sum, the payment constitutes income to the landlord.

The government also cites the case of *Helvering v. Smith* (C. C. A. 2), 90 F. (2d) 590, which likewise is not in point. In this case the taxpayer was a partner in a law firm and under the partnership agreement it was provided that a retiring partner should not be entitled to any part of any earnings for services performed after dissolution, but was to receive in full satisfaction only such partner's due pro rata share of such earnings actually collected and for services theretofore performed. The lease, furniture and law library were to belong to those who continued the business and the retiring partner got nothing for his share in the goodwill. The taxpayer retired from the firm and released his partners from all liability for a cash payment of $125,000.00. The Court held that under this set of facts the transaction was not a sale, because he got nothing which was not his and gave up nothing which was." The Court further pointed out that except for the "purchase," all his collections would have been income because the remaining partners would merely have turned over to him his existing earnings already made. He had nothing to sell. He received only his portion of the moneys. This is an entirely different situation than the instant case where James Adamson sold an interest in assets, or in a partnership which had assets in which he had an interest.

The government also cites the case of *Doyle v. Commissioner,* 102 F. (2d) 86, which also involved a law

partnership, which upon the date of its dissolution had a claim for fees against the F. W. Woolworth Company. He sold no assets of any kind, but merely sold his interest in a fee which had already been earned.

On the other hand, in the *Estate of George R. Nutter, supra,* the surviving partners of a law partnership purchased the deceased partner's interest in the capital assets receivables, possibilities and goodwill of the firm, by paying to decedent's beneficiaries a stated percentage of future earnings of the succeeding partnership for a certain period of time. The Tax Court distinguished the case of *Helvering v. Smith* by pointing out that in the cited case the retiring partner had no interest in the future earnings to sell to his copartners. The Tax Court ruled in the *Nutter* case that the proceeds received by the decedent's heirs were in payment of corpus and therefore not income.

The government cites several cases as ruling that partnerships have not been treated as separate entities. None of these cases are in point; and none of them are of any aid in resolving the question presented in the instant case, except for the case of *Neuberger v. Commissioner*, 311 U. S. 83, where the Court made this observation:

> "It is true, too, that in some cases the characteristics of partnerships as business units have been emphasized . . . while in others the characteristics of partnerships as associations of individuals have been stressed. . . . These cases, not decided under the Revenue Act of 1932 and turning, as they must, on their own peculiar facts are little aid in ascertaining the effect to be given to Section 23(2)(1)."

Conclusion.

It is respectfully submitted that the facts are clear and uncontradicted, that the taxpayer, James H. Adamson, sold either (1) an undivided one-half interest in an invention, in a patent, in a trademark and in two contracts with United States Rubber Company which he held as an investment and not in the course of any trade or business, or (2) an interest in a partnership which he held since 1925 to the date of sale October 20, 1939. In either case, it is respectfully submitted that the sale constituted the sale of a capital asset and the gain therefrom constituted a long term gain within the meaning of the Internal Revenue Code as it existed at the time and under the authorities cited herein.

It is respectfully submitted that the judgment of the trial court should be affirmed.

Respectfully submitted,

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